

# CALLAN ASSOCIATES<sup>INC.</sup>



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October 12, 2006

Alaska Retirement Management Board  
State of Alaska, Department of Revenue  
Treasury Division  
333 Willoughby Avenue, 11th Floor  
Juneau, AK 99801

Dear Board Members:

This letter reviews the investment performance of the Alaska Retirement Management Board (ARMB) for the fiscal year ended June 30, 2006.

Callan Associates Inc. (Callan) independently calculates time-weighted performance statistics based on underlying custodial data provided by the Board's custodian, State Street Bank and Trust Company. The performance calculations were made using a time-weighted return methodology based upon market values. Callan Associates Inc. serves as ARMB's independent general investment consultant and evaluates the Board's performance in relation to market benchmarks, appropriate manager peer groups and other public pension systems. The performance calculations were made in compliance with Global Investment Performance Standards.

ARMB's primary investment objective is to prudently and expertly invest assets, in accordance with governing law and industry practices, in a manner that will help ensure assets under supervision are sufficient to pay promised benefits to its members and their beneficiaries. In pursuit of this objective, the ARMB periodically evaluates liabilities, expected contributions, and potential earnings. This analysis is used to consider a wide range of potentially viable investment strategies. The Board selects a strategic investment policy that balances long-term growth potential and acceptable risk. A policy benchmark is constructed that mirrors the Board's strategic asset allocation policy. This policy benchmark is a custom index comprised of equity, fixed income, real estate and other market indices weighted in the same proportions as ARMB's investment policy.

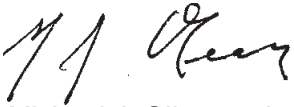
Fiscal year 2006 was a year of good progress for domestic equity and strong performance by international stocks. The Russell 3000 Index, a measure of the broad U.S. equity market achieved a solid return of 9.56%. International stocks, as measured by the MSCI EAFE Index, posted an exceptional overall return of 26.56%. Interest rate increases hurt bond prices and performance. The Lehman Aggregate Bond Index, a widely used measure of the investment grade domestic bond market, suffered a small negative return of 0.81%. Equity real estate enjoyed another strong year with returns of more than 18%.

For the fiscal year, the Public Employees' Retirement System (PERS) had a time-weighted total return of 11.74% and the Teachers' Retirement System (TRS) had a time-weighted total return of 11.78%. Both Systems exceeded their strategic policy benchmark target return of 10.38% and ranked in the 22nd and 21st percentile respectively of Callan's Public Fund database. The policy benchmark was largely unchanged during the year. Over the trailing 3-year period, a span that includes three years of recovering equity market returns, PERS and TRS have achieved annualized returns of 11.90% and 11.93% respectively. These results were slightly better than the policy target index return of 11.63% and also above the Callan Public Fund database median. These results have largely offset the weak returns experienced during the fiscal 2001-2003 period. Over the longest period for which Callan has detailed data (14 3/4 years), PERS and TRS have achieved annualized total returns of 8.89% and 8.96% respectively while the policy benchmark return for the same span was 8.83%.

Both systems are well diversified and currently have asset allocation policies that, in our opinion, are slightly more conservative than that of the average public fund.

In summary, fiscal 2006 was another strong year that helps demonstrate the wisdom of broad diversification across multiple asset classes.

Sincerely,

A handwritten signature in black ink, appearing to read "M. J. O'Leary".

Michael J. O'Leary, Jr., CFA  
Executive Vice President

**Department of Revenue  
Treasury Division  
Staff**

**Commissioner**  
William Corbus

**Chief Investment Officer**  
Gary Bader

**Investment Officers**

Bob G. Mitchell  
Stephen R. Sikes  
Philip Bartlett  
Zachary Hanna  
Victor Djajalie  
James McKnight

Casey Colton  
Clay Cummins  
Nicholas Orr  
Ryan Bigelow  
Bree Simpson

**Deputy Commissioner**  
Tomas Boutin

**Comptroller**  
Susan Taylor, CPA

**Cash Management**  
Michelle M. Prebula, MBA, CPA, CCM

**ARMB Liaison Officer**  
Judy Hall

**External Money Managers and Consultants**

**Investment Consultants**

Callan Associates, Inc.  
*Denver, CO*  
The Townsend Group  
*San Francisco, CA*

Relational Investors LLC  
*San Diego, CA*

Tukman Capital Management, Inc.  
*San Francisco, CA*

**Investment Advisory Council**

William Jennings  
*Colorado Springs, CO*  
Jerrold Mitchell  
*Wayland, MA*  
George Wilson  
*Boston, MA*

**Domestic Equity Small Capitalization**

Jennison Associates LLC  
*New York, NY*  
Lord Abbett & Co.  
*Jersey City, NJ*  
Luther King Capital Management  
*Fort Worth, TX*  
Trust Company of the West  
*New York, NY*  
Turner Investment Partners, Inc.  
*Berwyn, PA*

**Absolute Return**

Cadogan Management, LLC  
*New York, NY*  
Crestline Investors, Inc.  
*Fort Worth, TX*  
Mariner Investment Group, Inc.  
*Harrison, NY*

**Domestic Equity Index Fund**

State Street Global Advisors  
*Boston, MA*

**Domestic Fixed-Income**

BlackRock Financial Management, Inc.  
*New York, NY*

**Emerging Markets**

Capital Guardian Trust Co.  
*Los Angeles, CA*  
J.P. Morgan Fleming Asset Management, Inc.  
*New York, NY*

**Domestic Equity Large Capitalization**

Capital Guardian Trust Co.  
*Los Angeles, CA*  
Dresdner RCM Global Investors  
*San Francisco, CA*  
McKinley Capital Management, Inc.  
*Anchorage, AK*

**Global Equity**

Lazard Freres Asset Management  
*New York, NY*

## External Money Managers and Consultants (con't)

### High Yield

ING Investment Management  
Hartford, CT  
MacKay Shields LLC  
New York, NY

### International Equity – EAFE

Brandes Investment Partners, L.P.  
San Diego, CA  
Capital Guardian Trust Co.  
Los Angeles, CA

### International Fixed-Income

Mondrian Investment Partners  
London, England

### Private Equity

Abbott Capital Management, L.P.  
New York, NY  
Blum Capital Partners  
San Francisco, CA  
Pathway Capital Management, LLC  
Irvine, CA

### Real Estate – Agriculture

Hancock Agricultural Investment Group  
Boston, MA  
UBS AgriVest, LLC  
Hartford, CT

### Real Estate – Commingled Funds

Cornerstone Real Estate Advisers, LLC  
Hartford, CT  
Coventry Real Estate Fund II, LLC  
New York, NY  
Heitman Capital Management  
Chicago, IL  
ING Clarion Partners  
New York, NY  
J.P. Morgan Investment Management Inc.  
New York, NY  
Lehman Brothers Real Estate Partners  
New York, NY  
Lowe Hospitality Investment Partners, LLC  
Los Angeles, CA  
Sentinel Real Estate Corporation  
New York, NY  
UBS Realty Investors, LLC  
Hartford, CT

### Real Estate – Core Separate Accounts

Cornerstone Real Estate Advisers, Inc.  
Hartford, CT  
LaSalle Investment Management  
Chicago, IL  
Sentinel Real Estate Corporation  
New York, NY  
UBS Realty Investors, LLC  
San Francisco, CA

### Real Estate – Value Added Separate Accounts

Invesco Realty Advisors  
Dallas, TX  
Lowe Enterprises Investment Management Inc.  
Los Angeles, CA

### Global Master Custodian

State Street Bank & Trust Co.  
Boston, MA

### Independent Auditors

KPMG LLP  
Anchorage, AK

### Legal Counsel

Wohlforth, Johnson, Brecht,  
Cartledge & Brooking  
Anchorage, AK

## Public Employees' Retirement System Investment Report

The Investment Report was prepared by the State of Alaska, Department of Revenue, Treasury Division.

The basis of presentation for the data reported in the investment section is in accordance with the Association for Investment Management and Research (AIMR) Performance Presentation Standards.

### INVESTMENTS

The State of Alaska Public Employee Retirement System's (PERS) investment goals are the long-term return and sustainability of the pension funds under management. Near-term market fluctuations are integrated into the overall outlook of the fund guidelines. Annually, the Alaska Retirement Management Board (ARMB) sets its asset allocation strategy in order to reflect changes in the marketplace while still retaining an optimal risk/return level within the set constraints and objectives of the ARMB.

During the 2006 fiscal year<sup>1</sup>, ARMB's asset allocation was 36% domestic equities, 15% international equities, 24% domestic fixed-income, 2% international fixed-income, 9% real estate, 6% private equity, 3% absolute return, 2% high yield fixed-income, and 3% other (farmland and energy).

For the 2006 fiscal year, PERS investments generated a 11.74% rate of return. The PERS annualized rate of return was 6.54% over the last five years. The annualized rate of return over the last fourteen and three-quarter years has been 8.89%.

### INVESTMENT OVERVIEW

The diversification of the PERS investment portfolio continued to protect overall returns. For the 2006 fiscal year, the real estate portfolio gained 18.58% and the international equity portfolio gained 28.73%. The U.S equity portfolio generated a 9.23% return up from 4.47% the previous year.

### EQUITIES

The Total Domestic Equity Pool is diversified across large cap value, large cap growth, core, small cap value and small cap growth equity styles so as to gain broad market exposure. For the 2006 fiscal year, the fund posted a return of 9.23%. This was less than the target return of 9.67%. The annualized domestic equity return for the five-year period was 2.44% from a negative 1.94% in the 2005 fiscal year. Investment guidelines for all asset classes are approved by ARMB and govern investment objectives, program risk management and implementation, procedures for investment, and other operational requirements. Equity investment guidelines include policies with regard to the types of permissible equity investments, limitations on holding and investment of cash, proxy voting, and restrictions/prohibitions on the use of leverage and derivatives.

Within the International Equity pool, the non-U.S. equity style managers invest their assets only in non-U.S. equity securities. This style group excludes regional and index funds. The International Equity pool return was 28.73% which was greater than the target return of 26.56%. The international equity return for the five-year period was 11.14% from 1.82% in fiscal year 2005.

### FIXED-INCOME

The domestic fixed-income portfolio represented 21.6% of the total assets of PERS as of June 30, 2006. The fixed-income portfolio uses a core-oriented strategy investing in U.S. Treasury securities, U.S. Government Agency securities, investment-grade corporate bonds, and mortgage-backed securities. The benchmark for the PERS bond portfolio is the Lehman Brothers Aggregate Bond Index. Fixed-income investment guidelines include policies with regard to duration, credit quality, sector concentration, issue concentration, and company concentration.

<sup>1</sup> July 1, 2005 – June 30, 2006

## Public Employees' Retirement System Investment Report

Over the 2006 fiscal year, the PERS domestic bond portfolio gained 0.05%, down from 7.08% the year before. The Lehman Brothers Aggregate Bond Index returned a negative 0.81%, versus 6.80% during 2005 fiscal year. The annualized domestic fixed-income return for the five-year period was 5.23% from 7.60% in the 2005 fiscal year.

The international fixed-income portfolio, which represented about 2.1% of the total assets of PERS, returned a negative 0.27% over the 2006 fiscal year. The annualized international fixed-income return for the five-year period was 12.44% from 11.19% in the 2005 fiscal year. International fixed-income guidelines include policies with regard to duration, credit quality, sector concentration, issue concentration, company concentration, country restrictions, and currency hedging.

During the fiscal year PERS began investing in the High Yield Sector of the U.S. Fixed-Income Market. High yield fixed-income guidelines include policies with regard to duration, credit quality, geographic concentration, sector concentration, issuer concentration, and restrictions/prohibitions on the use of leverage and derivatives. The High Yield portfolio which represented 1.6% of the total assets of PERS, returned 5.55% over the 2006 fiscal year. This was more than the target return of 4.65%.

### REAL ESTATE

At the end of the 2006 fiscal year, PERS had 10.3% of its portfolio invested in real estate. The portfolio is primarily invested in specific institutional properties geographically diversified across the U.S. Property types include apartments, office, industrial, and retail. The portfolio is also invested in value-added real estate funds and real estate investment trust (REIT) equity securities. Investing in real estate helps diversify the overall portfolio due to its low correlation to stocks and bonds. Real estate adds a stable source of income and provides a degree of inflation hedge. Real estate guidelines include policies with regard to property quality, geographic

concentration, property size, property type, leverage, insurance coverage, and environmental evaluations.

The total return for real estate, net of fees, was 18.58% in fiscal year 2006 compared to 17.42% for the 2005 fiscal year. The five-year annualized net total return was 12.27% from 10.65% in the 2005 fiscal year.

### PRIVATE EQUITY

Six percent of the PERS portfolio is invested in Private Equity for long-term return enhancement and diversification. Investments are made through three investment managers. These investment managers have invested in over 100 private equity partnerships focused on venture capital, buyouts, or special situations. The private equity portfolio is well diversified by strategy, industry, geography, manager, and time. Private equity policies and procedures include guidelines with regard to investment quality, diversification, investment structure, and operation of the program.

During the 2006 fiscal year, the Private Equity component of the PERS portfolio had a net return of 25.89% with a five-year annualized return of 5.00%.

### ABSOLUTE RETURN

During the 2005 fiscal year the PERS portfolio began investing in absolute return strategies for additional diversification. Absolute return investments are made through three fund-of-fund managers and are 2.5% of the total portfolio. Each fund is well diversified by strategy and manager and targets a 5% real return with low correlation to equity and fixed-income markets. Absolute return policies and procedures include guidelines with regard to investment objectives, investment structure, investment quality, leverage, liquidity, strategy, manager concentration, risk management, and operation of the program. Absolute Return returned 10.51% over the 2006 fiscal year. This was more than the target return of 8.39%.

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**Public Employees' Retirement System  
Investment Report****OTHER**

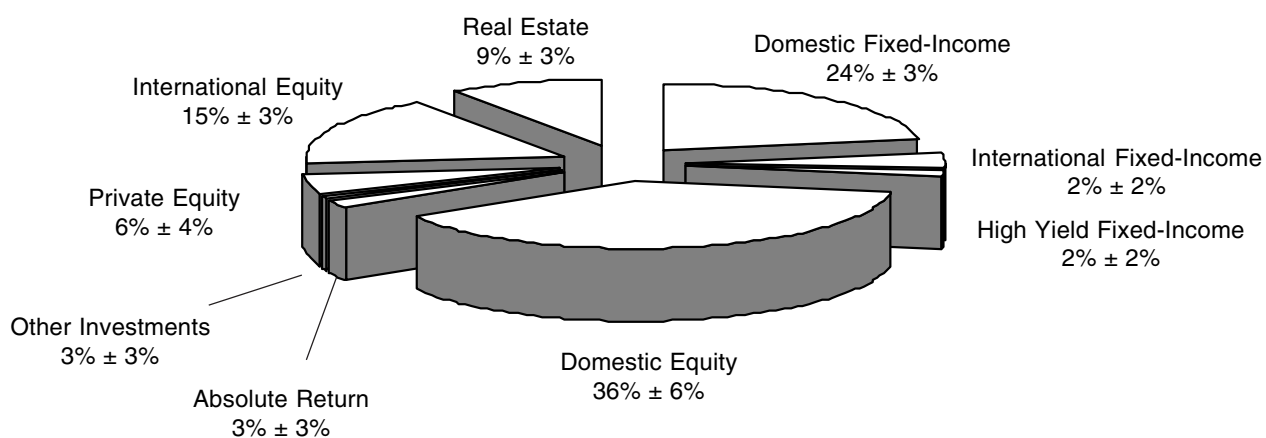
The PERS portfolio is also invested in farmland and energy investments. These investments are relatively new and are focused on providing the portfolio with additional diversification. The farmland investments are made through two separate account managers responsible for assembling a well diversified portfolio. The energy investment manager is focused on creating a balanced and diversified portfolio of oil, gas, and electric investments. Collectively, farmland and energy investments represent 0.8% of the overall portfolio and had a net return of 8.56% for the 2006 fiscal year.

Public Employees' Retirement System Schedule of Investment Results Fiscal Years Ended June 30							
	2002	2003	2004	2005	2006	Annualized	
						3 Year	5 Year
<b>Total Fund</b>							
PERS	(5.48%)	3.67%	15.08%	8.95%	11.74%	11.90%	6.54%
Actuarial Earnings Rate	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%	8.25%
<b>U.S. Common Stock Returns</b>							
PERS Domestic Equities	(16.85%)	(0.97%)	20.06%	4.47%	9.23%	11.07%	2.44%
S&P 500/Russell 2000 Composite	(17.99%)	0.25%	19.11%	6.87%	9.67%	12.48%	3.63%
<b>International Stock Returns</b>							
PERS International Equities	(8.27%)	(5.18%)	31.71%	14.96%	28.73%	24.91%	11.14%
Morgan Stanley Capital International EAFE	(9.49%)	(6.46%)	32.37%	13.65%	26.56%	23.94%	10.02%
<b>Domestic Fixed-Income</b>							
PERS	8.17%	10.69%	0.60%	7.08%	0.05%	2.54%	5.23%
Lehman Brothers Aggregate Index	8.63%	10.40%	0.32%	6.80%	(0.81%)	2.05%	4.97%
<b>International Fixed-Income</b>							
PERS	22.56%	24.48%	7.52%	9.84%	(0.27%)	5.61%	12.44%
Salomon Non-U.S. Government	15.73%	17.90%	7.60%	7.75%	(0.01%)	5.05%	9.61%
<b>Real Estate Equity</b>							
PERS	5.24%	8.97%	11.55%	17.42%	18.58%	15.81%	12.27%
NCREIF	5.60%	7.64%	10.83%	18.02%	18.79%	15.79%	12.01%
S&P 500 = Standard & Poor's Domestic Equity Stock Index EAFE = Europe, Australia, and Far East Stock Index NCREIF = National Council of Real Estate Investment Fiduciaries Index							

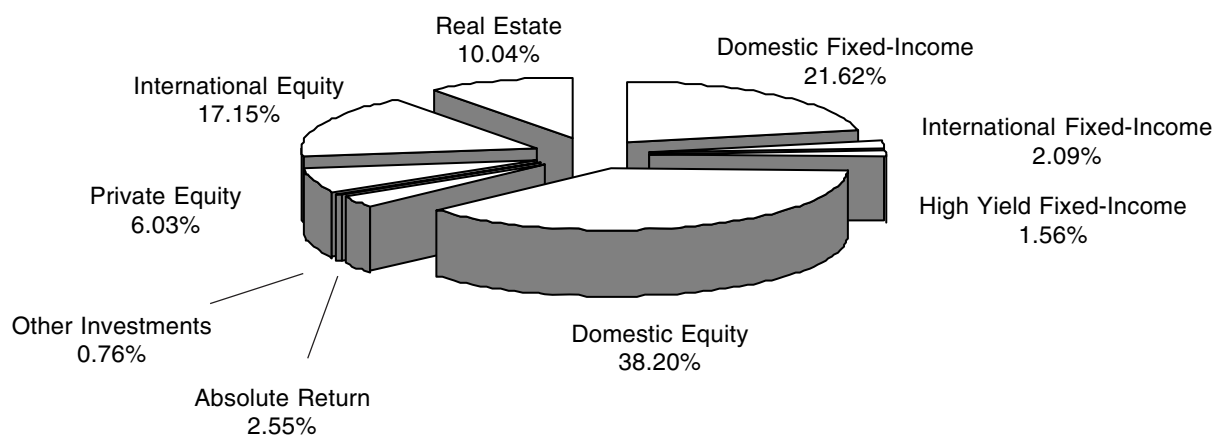


**Public Employees' Retirement System  
Asset Allocation  
June 30, 2006**

**Policy**

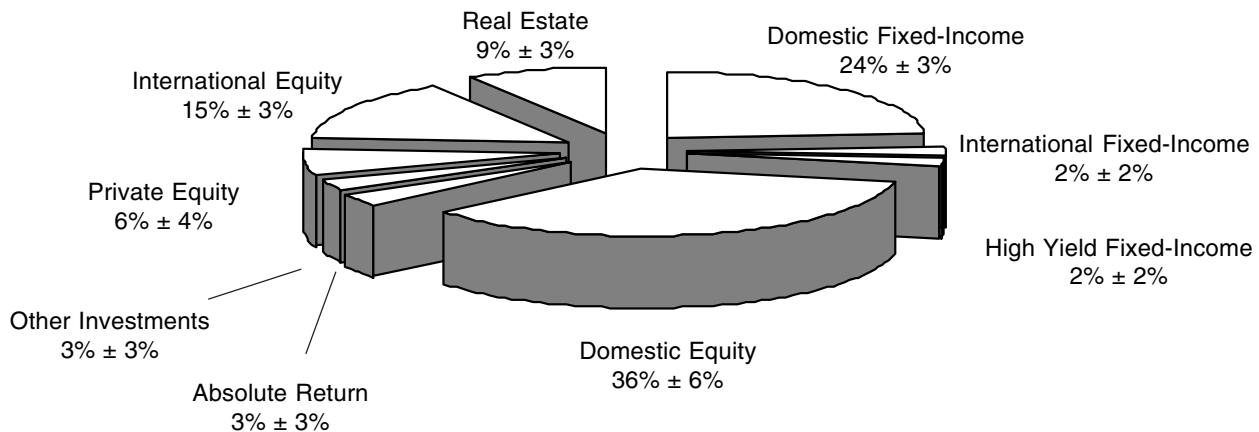


**Actual**

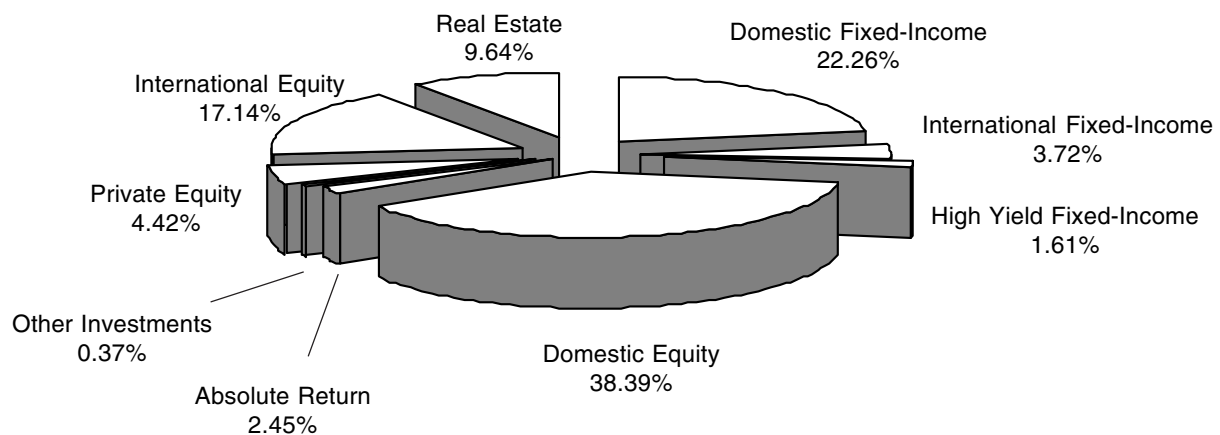


**Public Employees' Retirement System  
Asset Allocation  
June 30, 2005**

**Policy**



**Actual**



**Alaska Retirement Management Board  
Top Ten Holdings by Asset Type  
June 30, 2006**

Invested assets under the fiduciary responsibility of the ARMB have been commingled in various investment pools to minimize costs and maximize returns. The Treasury Division has created twelve different mutual fund-like pools to accomplish the investment asset allocation policies of the ARMB. Using investment pools increases investment efficiency in three ways. First, combining individual funds' cash inflows and outflows to offset each other reduces the amount of cash on hand needed to support daily operations. Second, pooling investments significantly reduces accounting, budgeting, and administrative costs. Finally, the ARMB can achieve economies of scale by making available investment options that could not otherwise be practically provided for smaller retirement funds. Following are the ten largest bond holdings and the ten largest equity holdings by market value as of June 30, 2006.

	<b>Rank</b>	<b>Fair Value</b>	<b>Par Values/ Shares</b>	<b>Security</b>	<b>Coupon</b>	<b>Maturity</b>	<b>Credit Rating</b>
<b>Fixed- Income</b>	1	\$138,460,389	\$138,500,000	FNMA Discount Notes	0.00%	7/5/2006	AAA
	2	\$78,596,681	\$60,105,000	U.S. Treasury Bond	8.50%	2/15/2020	Not Rated
	3	\$68,606,481	\$71,500,000	Federal National Mtg. Assn.	5.50%	8/1/2036	Not Rated
	4	\$61,082,019	\$62,128,000	Federal National Mtg. Assn.	6.00%	8/1/2036	Not Rated
	5	\$59,425,080	\$62,450,000	U.S. Treasury Notes	4.50%	2/15/2016	Not Rated
	6	\$55,410,756	\$59,300,000	Federal National Mtg. Assn.	5.00%	8/1/2036	Not Rated
	7	\$30,994,196	\$68,000,000	Federal National Mtg. Assn.	0.00%	10/9/2019	Not Rated
	8	\$30,242,087	\$30,261,000	U.S. Treasury Notes	5.13%	6/30/2008	Not Rated
	9	\$28,196,688	\$28,700,000	Federal Home Loan Banks	4.43%	4/7/2008	AAA
	10	\$23,993,778	\$25,544,280	Federal National Mtg. Assn.	5.00%	11/1/2033	Not Rated
<b>Equities</b>	1	\$124,351,488	3,772,800	General Electric			
	2	\$84,623,736	3,631,920	Microsoft			
	3	\$82,114,398	1,338,458	Exxon Mobil			
	4	\$66,661,646	1,385,897	Bank America			
	5	\$65,437,596	1,089,900	PepsiCo			
	6	\$64,607,253	1,339,288	Citigroup			
	7	\$63,669,434	1,062,574	Johnson & Johnson			
	8	\$59,815,229	1,012,959	American Int'l Group			
	9	\$54,467,928	979,639	Procter & Gamble			
	10	\$52,860,990	1,258,595	JP Morgan Chase			

Note: As of June 30, 2006, the PERS owned 67.86% of the fixed-income securities listed above and 68.13% of the equity securities listed above.

Additional investment information may be obtained from the Department of Revenue, Treasury Division, P.O. Box 110405, Juneau, Alaska 99811-0405.

**Public Employees' Retirement System  
Schedule of External Management Fees  
Year Ended June 30, 2006**

	<u>Fair Value</u>	<u>Fees</u>
<b>Investment Management Fees</b>		
Domestic Fixed-Income		
Blackrock Financial Management, Inc.	\$ 560,745,705	634,063
International Fixed-Income		
Mondrian Investment Partners	196,326,644	435,850
High Yield Pool		
ING Investment Management	73,441,954	356,413
MacKay Shields, LLC	72,853,772	320,242
Total High Yield	146,295,726	676,655
Domestic Equity Pool		
Cap Guardian Trust Co.	263,848,004	558,953
TCW Asset Management Company	202,402,073	1,496,319
SSgA S&P 500 Index Fund	1,356,290,803	200,596
Jennison Associates, LLC	127,713,367	1,000,933
Lord Abbett & Co	121,892,689	811,338
Luther King Capital Management	89,094,463	515,006
Lazard Freres	262,650,441	913,359
McKinley Capital Management	231,751,905	771,363
RCM	313,881,938	843,490
Relational Investors, LLC	200,597,076	2,316,532
Russell 2000	8,591,984	803
Tukman, Value	201,186,255	1,089,176
Turner Investment Partners	200,002,410	1,157,782
Total Domestic Equity Pool	3,579,903,408	11,675,650
Private Equity Pool		
Blum Capital Partners-Strategic	23,079,998	449,441
Blum Capital Partners-Public	33,340,726	310,184
Pathway Capital Management LLC	161,328,977	522,883
Abbott Capital	347,592,936	772,544
Total Private Equity	565,342,637	2,055,052
International Equity Pool		
Brandes Investment Partners	357,117,797	1,678,125
Cap Guardian Trust Co	333,383,838	1,141,156
Lazard Freres	326,391,292	735,219
McKinley Capital Management	209,405,164	944,557
State Street Global Advisors	200,453,552	915,484
Total International Equities	1,426,751,643	5,414,541
Absolute Return Pool		
Mariner Investment Group	78,063,656	1,005,033
Cadogan Management LLC	78,750,205	951,546
Crestline Investors, Inc.	82,316,332	1,062,907
Total Absolute Return	239,130,193	3,019,486

**Public Employees' Retirement System  
Schedule of External Management Fees (con't)  
Year Ended June 30, 2006**

	<u>Fair Value</u>	<u>Fees</u>
Other Investment Pool		
TCW Energy Fund	\$ 27,598,340	287,779
UBS Agrivest, LLC	31,869,329	146,216
Hancock Agricultural Investment Group	11,565,833	42,202
Total Other Investment	<u>71,033,502</u>	<u>476,197</u>
Emerging Markets Equity Pool		
JP Morgan Investment Management	83,448,385	495,939
The Capital Group Inc.	96,876,003	563,428
Total Emerging Market	<u>180,324,388</u>	<u>1,059,367</u>
Real Estate Pool		
J.P. Morgan Liquidity Fund	867	-
Cornerstone Real Estate Advisors	122,318,540	717,884
Lasalle Investment Management	149,074,967	863,167
Coventry Real Estate Advisors	10,912,129	318,938
Lowe Hospitality Investment Partners	19,912,240	170,425
Lowe Enterprises	-	238,476
Tishman Speyer Real Estate Venture VI	29,450,956	166,927
Rothschild Five Arrows	12,502,586	426,062
Cornerstone Rotational Fund	39,874,596	47,801
ING Clarion Partners	13,019,764	-
Lehman Brothers Real Estate Partners	21,519,425	1,505,005
J.P. Morgan Strategic Property	136,685,443	992,105
UBS Brinson Consolidated Account	54,256,204	543,970
UBS Brinson Separate Account	212,361,155	1,108,606
Sentinel Real Estate Corporation	50,117,546	264,851
Invesco Realty Advisors	-	2,186,143
Total Real Estate	<u>872,006,418</u>	<u>9,550,360</u>
Total	<u>\$7,837,860,264</u>	<u>34,997,221</u>
Custodian		
State Street Corporation		880,586
Investment Advisory		
Callan Associates		38,741
The Townsend Group		158,831
Total Investment Advisory		<u>197,572</u>
Investment Performance Measurement		
Callan Associates		163,197
Total External Management Fees		<u>\$36,238,576</u>

**Public Employees' Retirement System  
Investment Summary Schedule  
June 30, 2006**

	<u>Asset Allocation Policy</u>	<u>Range</u>	<u>Market Value</u>	<u>% of Asset Class</u>	<u>% of Total Assets</u>
<b>Participation in Pools Owning Fixed-Income Securities</b>					
<b>Domestic</b>					
Short-Term			\$ 559,886	0.03%	0.01%
Retirement			1,465,310,842	72.30%	15.63%
External			<u>560,745,705</u>	<u>27.67%</u>	<u>5.98%</u>
Total Domestic Fixed-Income	24%	21-27%	2,026,616,433	<u>100.00%</u>	21.62%
<b>International</b>					
International Fixed Income Pool	2%	0-4%	196,326,644	<u>100.00%</u>	2.09%
<b>High Yield</b>					
High Yield Fixed Income Pool	<u>2%</u>	<u>0-4%</u>	<u>146,295,726</u>	<u>100.00%</u>	<u>1.56%</u>
Total Fixed-Income	<u>28%</u>	<u>21-35%</u>	<u>2,369,238,803</u>		<u>25.27%</u>
<b>Participation in Pools Owning Domestic Equities</b>					
Small cap <sup>(1)</sup>	6%	3-9%	749,697,984	20.94%	8.00%
Large cap	<u>30%</u>	<u>27-33%</u>	<u>2,830,205,424</u>	<u>79.06%</u>	<u>30.20%</u>
Total Domestic Equities	<u>36%</u>	<u>30-42%</u>	<u>3,579,903,408</u>	<u>100.00%</u>	<u>38.20%</u>
<b>Participation in Pools Owning International Equities</b>					
International			1,426,751,643	88.78%	15.23%
Emerging Markets			<u>180,324,388</u>	<u>11.22%</u>	<u>1.92%</u>
Total International Equities	15%	12-18%	<u>1,607,076,031</u>	<u>100.00%</u>	<u>17.15%</u>
<b>Participation in Pools owning Alternative Investments</b>					
Private Equity	6%	2-10%	<u>565,342,637</u>	<u>100.00%</u>	<u>6.03%</u>
Other Investments	3%	0-6%	<u>71,033,502</u>	<u>100.00%</u>	<u>0.76%</u>
Absolute Return	3%	0-6%	<u>239,130,193</u>	<u>100.00%</u>	<u>2.55%</u>
<b>Participation in Real Estate</b>					
Mortgages, net of allowances			1,507	0.00%	0.00%
Real Estate Pool			<u>940,936,275</u>	<u>100.00%</u>	<u>10.04%</u>
Total Real Estate	<u>9%</u>	<u>6-12%</u>	<u>940,937,782</u>	<u>100.00%</u>	<u>10.04%</u>
Total Invested Assets	<u>100%</u>		<u>\$ 9,372,662,356</u>		<u>100.00%</u>

<sup>(1)</sup> Includes only securities held by those managers with small cap mandates. Does not include small cap holdings which may be held in other managers' portfolios.

**Public Employees' Retirement System  
Recaptured Commission Fees  
Year Ended June 30, 2006**

<u>Domestic Equity</u>	<u>International Equity</u>	<u>Total</u>
\$ 480,095	169,363	649,458

The ARMB's Commission Recapture program has been in place since 1995, first working with various brokers then switching to the State Street program in 2005. Under a commission recapture program a portion of the commissions and mark-ups on trades (placed through the State Street broker network) flow directly back to the fund.

The program allows managers to place trades for commission recapture purposes. The ARMB has established direction percentages for the managers to strive for, but is only requiring best efforts to meet them given their fiduciary obligation to achieve best execution of transactions.

The current rebate arrangement with State Street Global Markets is: 80% of the brokerage commissions earned in executing domestic equity transactions; 72% of the brokerage commissions earned in executing domestic equity transactions via correspondent brokers; and, 60% of the brokerage commissions earned in executing international equity transactions.

**Net Securities Lending Income  
Year Ended June 30, 2006**

Securities lending income	\$ 33,552,331
Less Securities lending expense	<u>31,559,750</u>
Net income from securities lending activities	<u>\$ 1,992,581</u>

Alaska Statute 37.10.071 authorizes the ARMB to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The ARMB has entered into an agreement with State Street Corporation (the Bank) to lend equity and domestic fixed-income securities. The Bank, acting as the ARMB's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

Cash collateral is invested in a registered 2(a)-7 money market fund which is valued at amortized cost approximating fair value. The ARMB does not have the ability to pledge or sell securities collateral unless the borrower defaults, therefore securities collateral is not recorded on the financial statements.

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